'Vultures' Save Troubled Homeowners

By JAMES R. HAGERTY

Anna and Charlie Reynolds of St. George, Utah, were worried about losing their home to foreclosure last year. Then they got a lucky break—from an unlikely savior.

Tiffany Brown for the Wall Street Journal

Selene bought and modified Anna and Charlie Reynolds' home loan.

Selene Residential Mortgage Opportunity Fund, an investment fund managed by veteran mortgage-bond trader Lewis Ranieri, acquired the loan at a deep discount and renegotiated the terms with the Reynolds. The balance due was cut to $243,182 from $421,731, and the interest rate was lowered. That reduced the monthly payment to $1,573 from $3,464, allowing the family to stay in their home despite a drop in Mr. Reynolds' income as a real-estate agent. "It was a miracle," says Ms. Reynolds.

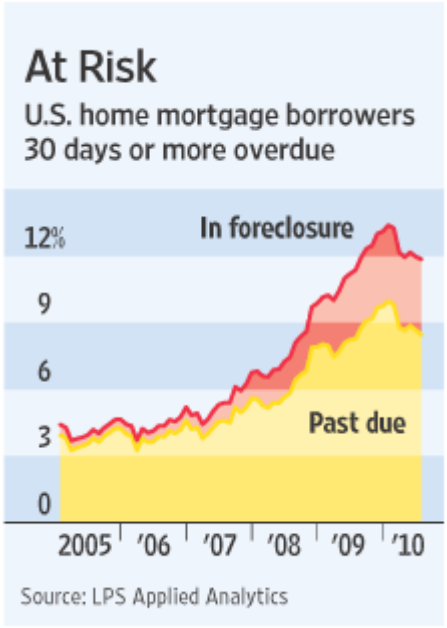
But Mr. Ranieri isn't your typical miracle worker. As a fund manager who was once vice chairman of the bond-trading firm Salomon Brothers, he's a member of the Wall Street crowd that is often pilloried for helping inflate the housing bubble, though he sat out the excesses of recent years. The 1989 book "Liar's Poker" made him famous for billion-dollar trades in mortgage bonds and junk-food "feeding frenzies" with his trading-desk buddies.

As the nation struggles with the worst foreclosure crisis since the 1930s, Mr. Ranieri's investment fund and others like it are emerging as the best hope for the roughly seven million U.S. households behind on their mortgage payments. Nimble, flush and willing to strike deals with borrowers, these funds have an edge over banks and other lenders that can be mired in bureaucracy and hampered by government rules about which loans can be renegotiated and how.

Borrowers less lucky than the Reynolds family must work with middlemen—loan-servicing firms that don't actually own loans, but represent banks and investors, and collect mortgage payments on their behalf. These firms follow often-ambiguous rules set by the owners of the loans. In cases where a loan has been bundled into a security, it might have thousands of owners scattered around the world, making it impossible to know all their preferences.

By contrast, Mr. Ranieri's Selene is the sole owner of its loans and has a servicing affiliate that can negotiate directly with borrowers. "Every case is individual," Mr. Ranieri says. "There's no template."

But the main reason Mr. Ranieri can strike deals with borrowers is that his firm buys loans, mostly from banks, at steep discounts to the balance due. If his fund pays $50,000 for a loan with a $100,000 balance due, for example, it can make a profit even if the borrower ends up paying back only $70,000.



Since mid-2007, nearly 3.4 million households have received loan modifications, according to industry data from the Hope Now alliance of loan servicers. But the group doesn't disclose how many of those borrowers have fallen behind on payments again. Many of the loan modifications granted in the early months of the default crisis didn't reduce payments for the borrowers and merely helped them catch up on arrears; some of those modifications resulted in higher payments.

Cutting the loan balance is one of the most effective ways to motivate borrowers to resume payments because it gives them more hope of eventually owning the home, say nonprofit groups that work with distressed borrowers. But analysts say banks have been reluctant to reduce principal, partly because that would require them to recognize losses they still hope to avoid. Their modifications almost always involve reducing the interest rate or giving the borrower more time to pay.

Around 90% of Selene's loan modifications involve reducing the principal, compared to less than 2% of the modifications done by federally regulated banks in the first quarter.

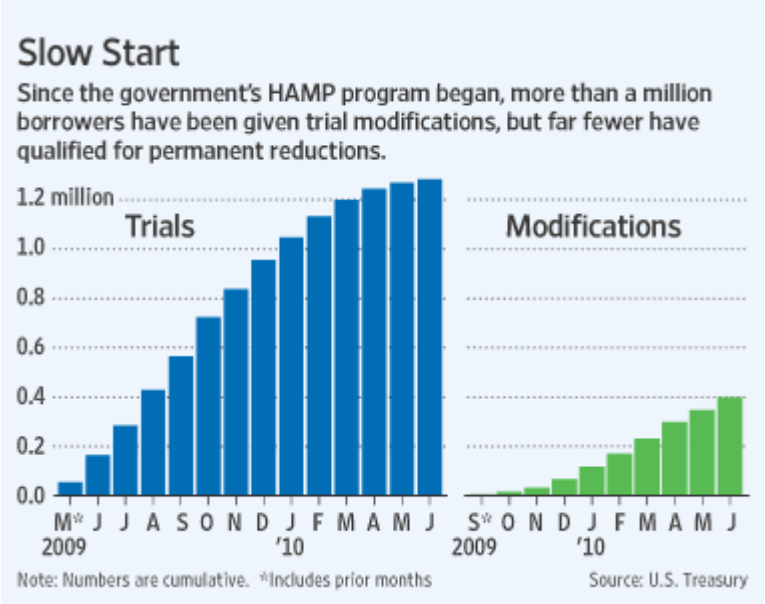
"There are obvious inconsistencies in treatment [of borrowers] depending on who owns and services the loan." says Edward Delgado, a former Wells Fargo & Co. executive who is now chief executive of Five Star Institute, a provider of training programs for mortgage professionals. To some extent, he says, "it's the luck of the draw."

But only the lucky few have so far benefited from Selene or other distressed-debt investors. Selene, which owns about $1 billion worth of home mortgages, will say only that it has modified "thousands" of loans, a drop in the bucket among the millions of overdue mortgages. Many loans are locked up in securities and thus unavailable for sale. In other cases, owners of loans aren't willing to take the losses that would be needed to mark down the mortgages enough to lure buyers like Selene.

Over the past two years, less than $25 billion of delinquent mortgages have been sold to investors who specialize in this area, estimates Dwight Bostic, a managing director of Mission Capital Advisors, which advises investors on mortgage transactions. That is only about 0.25% of U.S. home loans outstanding. But Mission Capital executives say the number of loans sold is likely to grow in this year's fourth quarter as banks try to clean up their books before year end. Some banks have more bad loans to sell because they have had to buy back from Fannie Mae and Freddie Mac mortgages that didn't meet quality standards.

Selene buys loans to make a profit on them, not as a public service, but company officials say it is often more profitable to keep the borrower in the home than to foreclose. If a delinquent loan can be turned into a "performing" loan, with the borrower making regular payments, the value of that loan rises, and Selene can turn around and either refinance it or sell it at a profit. Mr. Ranieri declines to discuss the fund's performance. But one of the shareholders, the Public Employees Retirement Association of New Mexico, reported that its holdings in the fund had a market value of $19.8 million as of June 30, up from $18 million in late 2008. That excludes distributions of profits to shareholders in the funds.

Once Selene acquires a loan, the firm immediately tries to contact the borrower, sometimes sending a FedEx package with a gift card that can be activated only if the borrower calls a Selene debt-workout specialist.



Paul Cheatham, a Houston oil-field engineer with two children, says he was worried about payments rising on his adjustable-rate mortgage and so was eager to talk when he got a registered letter from Selene saying it had acquired his loan and might be able to help. He says Selene was able to arrange lower payments and a fixed interest rate for him within about a month. "They helped me out," says Mr. Cheatham, who had fallen behind on payments because of a drop in income. Selene reduced his balance by $16,000, to $80,000, and his monthly payments to $541 from $831.

Selene says it's able to keep about half the borrowers it deals with in their homes through a refinancing or modified loan terms. Sometimes the company gets creative, paying off other debts, such as car loans, to lower a borrower's overall debt load enough to qualify for a refinancing. In roughly 20% of cases, the home is sold without a foreclosure in a so-called short sale for less than the balance due.

As for the remaining 30% or so of cases—their luck runs out when Selene proceeds with foreclosure. The company says some borrowers can't afford their homes, even at the reduced terms the fund would be willing to offer.

One reason Selene has the leeway to help borrowers is that it generally bypasses the federal government's $50 billion Home Affordable Modification Program, or HAMP. The program offers financial incentives to lenders and servicers to modify loans. When President Barack Obama announced HAMP 18 months ago, the program raised hopes among millions of borrowers. As of June 30, however, only about 389,000 households were benefiting from long-term reductions in payments under that program, and 364,000 were in "trial" periods, trying to qualify by showing they could make reduced payments.

Critics say the program is overly complex, unwieldy and revised so often that servicers have a hard time keeping up with the latest requirements for modifications. The Treasury Department blames servicers. They "have done a terrible job of making sure that they are doing everything they can to meet the needs of their customers who are facing the possibility of losing their home," Treasury Secretary Timothy Geithner told a congressional panel in June.

Nonprofit counselors who help homeowners say far more borrowers have either failed to qualify or given up than have actually received modifications. Some borrowers have spent more than a year trying to find out whether they qualify.

Among those whose future is uncertain are Alberta and Arthur Bailey, who live in a bungalow in LaPlace, La. Mr. Bailey, 69 years old, worked for decades in an auto-body shop but retired after a stroke in 2002 and now needs a cane to get around.

The Baileys bought their bungalow in 2003 and hoped to spend the rest of their lives in it. In 2004, Mr. Bailey got a call from a loan officer from Countrywide Home Loans, now part of Bank of America Corp. The loan officer told the Baileys they had $33,000 of equity in their home and could refinance the loan in a way that would release some of that money. They used the money to repair the roof and install new doors, Mr. Bailey says.

The Baileys ended up with more debt than they could handle on their income of $1,600 a month in Social Security payments, plus food stamps. Help, however, has yet to arrive. The mortgage ended up as one of hundreds of mortgages owned by investors in a series of securities. Alexa Milton, a manager at Affordable Housing Centers of America, a nonprofit group counseling the Baileys, determined that they qualified for HAMP. But, she says, the servicer of the loan, Litton Loan Servicing LP, told her that the rules governing the securities don't allow for a HAMP loan modification.

A spokeswoman for Bank of America, which now owns Countrywide, the original issuer of those securities, disagrees, saying that the rules would allow a HAMP modification. A Litton spokeswoman declines to comment. A person familiar with the situation says Litton believes that the rules are ambiguous and so a modification would subject the servicing firm to the risk of lawsuits by the owners of the securities.

Litton has held off on foreclosure while studying other means of reducing the Baileys' payments, currently about $750 a month. "If I can get it down to $500 a month," says Mr. Bailey, "I can make it."